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November 7, 2002

RECEIVED

Marlene H. Dortch, Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: *Consolidated Application for Authority to **Provide** In-Region, InterLATA Services in Colorado, Idaho, Iowa, Nebraska, North Dakota, Montana, Utah, Washington, and Wyoming, WC Docket No. 02-314*

Dear Ms. Dortch.

In its reply comments in this proceeding, Qwest attempted to respond to the several commenters that questioned whether Qwest's application satisfied section 272 of the Communications Act, particularly that statute's accounting safeguards. As explained below, Qwest's answers only confirm that Qwest's existing long distance affiliate, QLDC, does not, and will not, comply with section 272. Accordingly, Qwest's application should be denied.

Failure to comply with section 272 cannot be considered a mere technicality that can be corrected by subsequent audits. The Commission has frequently stressed that "compliance with section 272 is of crucial importance because the . . . safeguards of section 272 seek to ensure that BOCs compete on a level playing field." Section 272 is "designed, in the absence of full competition in the local exchange marketplace, to prohibit anticompetitive discrimination and cost-shifting." Compliance with section 272(b)(2), in particular, is necessary to create "a uniform audit trail," that "discourage[s], and facilitat[es] detection of, improper cost allocations." For that reason, the Commission's rules implementing section 272(b)(2) provide that "the separate affiliates prescribed under section 272(a)(2) *must* maintain their books,

<sup>1</sup> *Texas 271 Order*, 15 FCC Rcd. 18354, ¶ 395 (2000) (citation omitted).

<sup>2</sup> *Non-Accounting Safeguards Order*, 11 FCC Rcd. 21905, ¶ 9 (1996).

<sup>3</sup> *Accounting Safeguards Order*, 11 FCC Rcd. 17539, ¶ 170 (1996).

<sup>4</sup> *Id.* ¶ 13.

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records, and accounts in accordance with **GAAP**.<sup>5</sup> Absent strict and uniform adherence to **GAAP**, Qwest could easily mislead auditors and regulators seeking to detect discrimination, just as Qwest has, by repeatedly violating **CAAP**, been misleading investors, lenders and regulators for years.

Indeed, Qwest has a sorry track record of *non*compliance with section 272 and has been forced to acknowledge pervasive and systemic violations of that provision. In its prior applications, Qwest nonetheless claimed that it had fixed all of the problems, and that on a going forward basis it would comply with all section 272 requirements.<sup>6</sup>

That promise was a hollow one. Late in the proceeding, it became clear that Qwest's initial representations to the Commission were false in critical respects. Specifically, it was revealed that the book, records, accounting policies and controls of Qwest's section 272 affiliate, QCC, were the subject of ongoing investigations by the SEC, the DOJ and others. In the absence of sound books, records, policies and controls, there obviously could be no assurance that Qwest would comply with its section 272 obligations on a going-forward basis, particularly with respect to the section 272(b)(2) requirement that the 272 affiliate demonstrate that its "books, records, and accounts" are maintained in accordance with GAAP. Given that there was no real dispute that the books of QCC were not GAM-compliant – indeed, Qwest's own CFO acknowledged this fact both in letters to the Commission and in sworn statements to the SEC<sup>7</sup> – Qwest ultimately conceded the obvious and withdrew its applications.

But the section 272 deficiencies triggered by Qwest's ongoing investigations go well-beyond QCC or section 272(b)(2). In fact, the record from the prior proceedings established that Qwest's very serious accounting problems extend to the *entire* Qwest corporate family, because, it is Qwest's accounting policies themselves – and not merely the isolated failures of particular Qwest entities to follow those policies – that have been found wanting and continue to be reviewed.\* Thus, Qwest acknowledged that QC, Qwest's BOC, and QCII, Qwest's holding company, could likewise not certify their books or financial statements as GAAP-compliant.<sup>9</sup> And Qwest also was forced to acknowledge in the prior proceedings that its internal controls are inadequate and need considerable strengthening.<sup>10</sup> It was (and is) thus clear that Qwest also

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<sup>5</sup> *Id.* ¶ 170 (emphasis added)

<sup>6</sup> *See, e.g.*, Qwest II, Schwartz Dec ¶ 44

<sup>7</sup> *See Ex Parte* Letter from Oren Shaffer to Marlene Dortch, WC Dockets No 02-148, 02-189, at 2 (August 20, 2002) ("August 20 Shaffer Letter")

<sup>8</sup> AT&T Supplemental Comments on § 272 Compliance (Qwest I) at 7-8, 17-20, 24-26

<sup>9</sup> *See* August 20 Shaffer Letter at 2

<sup>10</sup> *See id.*

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cannot satisfy the other section 272 accounting safeguard – section 272(c)(2)’s requirement that transactions between the BOC and the 272 affiliate be accounted for by the BOC in accordance with GAAP

In its current application, Qwest claims that, by simply creating out of whole cloth a new shell corporation (“QLDC”) to serve as its 272 affiliate, Qwest has solved its section 272 problems. Nothing could be farther from the truth. This window dressing does not address any of the underlying defects identified in the prior proceedings. And that is why Qwest has taken the unprecedented action of refusing to permit the relevant state regulatory commissions – which have the power to hold live hearings and conduct discovery – to review its corporate sleight-of-hand and instead has demanded that the Commission review its application without the benefit of state commission scrutiny.

Approval of this corporate shell game would lead to almost certain reversal by the court of appeals. QLDC is a sham corporation, with virtually no assets, office space, or employees.” Indeed, QLDC was conceived to be nothing more than a Trojan Horse. Despite Qwest’s equivocating to this Commission,<sup>12</sup> elsewhere Qwest has conceded that it intends to eliminate QLDC once it can plausibly claim that its accounting problems have been solved and re-establish QCC as its 272 affiliate.<sup>13</sup>

In light of these uncontested facts, the Commission must squarely reject Qwest’s claim that the Commission can approve this application based solely on a review of QLDC’s compliance with section 272. The courts – and the Commission<sup>14</sup> – have stressed that “form should be disregarded for substance and the emphasis should be on economic reality”<sup>15</sup> and have “consistently refused” to accept interpretation of federal statutes that would “give effect to the corporate form where it is interposed to defeat legislative policies.”<sup>16</sup> Indeed, the Commission

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<sup>11</sup> AT&T (Qwest III) at 18-23

<sup>12</sup> See Qwest III Application at 9 n.11

<sup>13</sup> AT&T (Qwest III) at 22 (citing admissions by Qwest); WorldCom at 20-21 (same)

<sup>14</sup> **Fox Television Stations**, 10 FCC Rcd. 8452, ¶ 48 (1995) (no weight can be given to “formalistic and formulaic” changes to corporate form in assessing compliance with substantive rules), **NextWave Order**, 12 FCC Rcd. 2030, ¶ 44 (1997) (the Commission will look to “the economic reality and substance of . . . transactions”); **Michigan 271 Order**, 12 FCC Rcd. 20543, ¶ 361 (1997) (holding that section 272 cannot be nullified “through a legal fiction”).

<sup>15</sup> *SEC v. Texas International Co.*, 498 F. Supp. 1231, 1240 (N.D.Ill. 1980) (quoting *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 99-100 (7th Cir. 1977))

<sup>16</sup> *First National City Bank v. Bano Para El Comercio Exterior de Cuba*, 462 U.S. 611, 630-31 (1983) (citing precedents).

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has held precisely this in construing the operative language of section 272, which requires a BOC to “provide” in-region interLATA services through a separate affiliate that complies with all the substantive requirements of sections 272(b)-(e).<sup>17</sup> The Commission in the *Qwest Teaming Order* squarely rejected the claim that “provide,” as used in the Communications Act, should be equated with only the physical transmission of communications, instead finding that the term must be construed in light of the core “statutory purpose” of the particular provision in which it is used.<sup>18</sup>

Here, Qwest’s proposal would undermine section 272’s “crucial[ly] important[.]”<sup>19</sup> purpose of preventing BOCs from using their control of bottleneck facilities to advantage their long distance offerings.” If accepted, Qwest’s proposal would limit application of the section 272 safeguards to QLDC despite the fact that this entity is a mere empty vessel that is clearly unable to “provide” by itself long distance service in the nine states for which Qwest is now seeking section 271 approval. If Qwest’s construction of the statute were accepted by this Commission, the Qwest companies actually “providing” long distance service in these states would not need to satisfy section 272’s accounting and structural safeguards and there would be no protections in place to prevent and detect discrimination in favor of these entities responsible for Qwest’s in-region long distance offering. Such a finding by this Commission would allow Qwest’s “exception” to subsume the rule.

Thus, for Qwest’s application to be approved, Qwest must identify the other entities that are, in fact, supplying the essential components of the Qwest long distance service that QLDC obviously cannot provide by itself, and show that all of these entities comply with section 272. Qwest does not even attempt such a showing and, therefore, its application flunks section 272.

At a minimum, by making clear its intention to eliminate QLDC in the near future and make QCC its sole 272 affiliate, Qwest must demonstrate that both QLDC and QCC satisfy section 272. Indeed, Qwest candidly acknowledged this obligation in announcing the creation of QLDC.” And this showing must be based on hard evidence of “*present* compliance”; a “paper promise” of “*future* performance” is insufficient to “satisfy [Qwest’s] burden of proof.”<sup>22</sup>

<sup>17</sup> See 47 U.S.C. § 272(a)(1)

<sup>18</sup> *Qwest Teaming Order*, 15 FCC Rcd. 21438, ¶¶ 28-37 (1998).

<sup>19</sup> *Kansas-Oklahoma 271 Order*, 16 FCC Rcd. 6237, 1256 (2001).

<sup>20</sup> *Accounting Safeguards Order* ¶ 14; *Non-Accounting Safeguards Order* ¶¶ 10-13

<sup>21</sup> Qwest III Schwartz Dec., Exh. MES-QC-13 (Qwest Today Announcements, Qwest Creates New ‘272’ Affiliate) (QLDC and QCC “must remain compliant with section 272” in order for Qwest to obtain section 271 approval”).

<sup>22</sup> *Michigan 27E Order* ¶ 55 (emphasis in original).

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In its present application, Qwest does not even claim that QCC presently complies with any provision of section 272, let alone provide any evidence that QCC today complies with sections 272(b)(2) and 272(c)(2). Nor could it. The past proceedings demonstrated that QCC's "books, records, and accounts" do not comply with GAAP and, therefore, that QCC does not satisfy section 272(b)(2). Indeed, if QCC could satisfy section 272(b)(2), there would have been no reason for Qwest to have resorted to creating QLDC in the first place.

But even if it could counterfactually be assumed that QLDC was the only relevant entity for section 272 purposes, Qwest still fails to satisfy that statute. Although Qwest tries to make a virtue out of the fact that QLDC was cobbled together just a few weeks ago, that fact is fatal to Qwest's application. The Commission has repeatedly held that the strongest evidence of going-forward compliance with section 272 is a history of compliance with section 272.<sup>23</sup> This is in accord with the holdings of the SEC, other federal regulatory agencies, and accounting standard setting bodies that uniformly hold that there is no substitute for a history of maintaining books in conformity with GAAP.<sup>24</sup>

Qwest cannot have it both ways. If QLDC is truly new, then it has no demonstrated history of compliance with section 272. And to the extent that QLDC is a successor to QCC and judged by that entity's past, only one conclusion could withstand appellate review – that QLDC would *not* abide by section 272's safeguards.

Further, the claim that the accounting problems that have prevented Qwest from certifying the books of QC, QCC, and QCII cannot affect QLDC because it is a "new" company is accounting nonsense. In the declaration that he filed in support of AT&T's initial comments, Professor William Holder, the Ernst & Young Professor of Accounting at the University of Southern California, explained that because i) Qwest's basic accounting policies themselves are under review; ii) Qwest's problems are systemic and pervasive; and iii) the full extent of its accounting irregularities are not yet known and will not be known until the ongoing investigations conclude, there can be no reasoned conclusion that QLDC's books comply with GAAP as required by section 272(b)(2).<sup>25</sup> *A fortiori*, this same logic precludes any finding that QC, which Qwest has conceded does not have GAAP-compliant books, is properly recording transactions with QLDC as required by section 272(c)(2).<sup>26</sup>

<sup>23</sup> *New York 271 Order* ¶ 402 ("past and present behavior of the BOC applicant provides the best indicator of whether [the applicant] will carry out the requested authorization in compliance with section 272."); *Michigan 271 Order* ¶ 55 (same).

<sup>24</sup> See *Ex Parte* Declaration of William Holder ¶ 19 ("Holder *Ex Parte* Dec.") (attached hereto).

<sup>25</sup> AT&T(Qwest III), Holder Dec ¶¶ 16-20.

<sup>26</sup> *Id*

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And even once GAAP-compliant policies and practices are eventually put into place by Qwest, they will not produce GAAP-compliant figures unless rigorous accounting controls are put in place as well.<sup>27</sup> It cannot be simply assumed that this will occur, as even Qwest has acknowledged that its internal controls are inadequate and need strengthening.<sup>28</sup> As Qwest's CFO has acknowledged under oath to the SEC that "the company needs to enhance certain internal controls."<sup>29</sup> Further, he has conceded that these "new internal controls that are needed will be identified and implemented" subject to a "thorough analysis of accounting practices for past periods" which "is expected to take several months before it is completed."<sup>30</sup>

In its reply comments, Qwest offers no persuasive response to these points. Qwest's threshold argument is to claim that the Commission can simply ignore the fact that Qwest cannot demonstrate compliance today on the ground that it "*will*" come into the compliance in the future." AT&T agrees that Qwest cannot demonstrate "present compliance," but the Act makes clear that the Commission cannot approve Qwest's application on the ground that Qwest will eventually come into compliance with section 272. Although section 271(d)(3)(B) requires the Commission to find that the "the requested authorization will be carried out in accordance with the requirements of section 272," section 272(a)(1) requires that a BOC may only "provide" in-region long distance through an affiliate that fully complies the accounting and structural safeguards of section 272. Read together, these provisions foreclose granting Qwest's applications until it can demonstrate that it will be in compliance with section 272 on the day it obtains interLATA authority *and* that it will remain in compliance in the future. Absent that showing – and Qwest expressly disclaims any showing of "present compliance" – there can be no Commission finding that this application satisfies section 272(a)(1) and no basis for approval under section 271(d)(3)(B).

Not only is Qwest's interpretation inconsistent with the text and structure of sections 271 and 272, it would produce absurd results. Qwest is effectively arguing that the Commission can approve its section 271 application even if it is clear that Qwest is not today in compliance with section 272 and will not be for a considerable time period in the future, so long as Qwest promises that it eventually **will** comply with the statute. That reading would render section 272's safeguards illusory.

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<sup>27</sup> *Id.* ¶¶ 21-26

<sup>28</sup> *See* August 20 Shaffer Letter at 2

<sup>29</sup> Qwest August 16, 2002 8-K at I2

<sup>30</sup> *Ex Parte* Letter from Oren Shaffer to Marlene Dortch, WC Dockets No. 02-148, 02-189, at 2 (August 26, 2002) ("August 26 Shaffer Letter") *See also Ex Parte* August 20 Shaffer Letter at 2

<sup>31</sup> Qwest 111 Reply at 9-11 (emphasis added)

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Nor can Qwest even demonstrate a basis for finding a likelihood of section 272 compliance going-forward. As noted above, in assessing the probability of continuing compliance, the Commission has held that the most probative evidence is the BOC's history of compliance. QLDC, of course, has virtually no history at all, and certainly no established history of compliance. And, to the extent that Qwest is correct that the Commission should look not at the 272 affiliate's history but at that of its parent or BOC-affiliate,<sup>32</sup> that track record is one of repeated violations of basic accounting principles. Thus, without any "actual evidence" of existing compliance, Qwest can simply not meet its burden with mere "paper promises" that it will comply in the future."

Qwest is also wrong that it need only demonstrate that QLDC – and not the other companies that will, in fact, also be "providing" Qwest's long distance service in the nine states for which Qwest is seeking authorization – is compliant with section 272. Contrary to Qwest's bare assertion, QLDC is not is a "fully functional company"<sup>34</sup> capable of "providing" long distance in nine states. The undisputed evidence is that QLDC has only \*\*\* 35  
QLDC apparently has \*\*\* 36  
And, as Qwest concedes, QLDC *is not even licensed to provide long distance in the states where it is seeking section 271 authority*.<sup>37</sup> It is absurd on its face to suggest that this all but empty shell is the entity that is going to launch, implement and manage – in short, "provide" – long distance service in nine states. The reality, of course, is that QC, the BOC, and QCC, Qwest's real long distance business unit (and once, and future, section

<sup>32</sup> *Id.* at 10.

<sup>33</sup> *Michigan 27f Order* ¶ 55. Qwest is attacking a straw man when it claims that under AT&T's test, Qwest would need to demonstrate years of section 272 compliance prior to filing an application. Rather, AT&T's argument is that, in the absence of hard evidence such as a thorough audit, a BOC must at least show that it has operated its affiliate over some reasonable period of time in compliance with section 272. Notably, the other BOCs routinely certify that their 272 affiliate's books have been audited and found to comply with GAAP. *See, e.g.*, SBC California, Carisalez Dec. ¶ 19; BellSouth Florida-Tennessee, Bhalla Dec. ¶ 12.

<sup>34</sup> Qwest III Reply at 6

<sup>35</sup> *Id.*, Brunsting Reply Dec., Exh. JLB-QLDC-6C.

<sup>1t</sup> *See* AT&T (Qwest III), Selwyn Dec. ¶ 39

<sup>17</sup> Qwest III Reply at 7-8. Although Qwest promises to secure the necessary approvals, "[e]vidence demonstrating that a BOC *intends to come into compliance* with the requirements of section 271 by day 90 is insufficient" *Michigan 271 Order* ¶ 55 (emphasis in original).

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272 affiliate), will be the actual “providers” of long distance service in every meaningful sense of the word.

This should not come as a surprise. As noted, Qwest has acknowledged (albeit, not to this Commission) that it intends to jettison QLDC as soon as it can plausibly claim that its prior affiliate, QCC, has solved its accounting problems. Thus, it is clear that Qwest views QLDC as a mere nuisance and the fewer resources devoted to it, the better.

Indeed, in its reply Qwest makes clear its strategy to prop up QLDC through hidden Qwest/QCC subsidies that, Qwest asserts, need not even comply with the Commission’s section 272 requirements or affiliate transaction rules.<sup>38</sup> Qwest thus contends that assets and services that flow from the BOC to QCC and then to QLDC need not be disclosed under section 272(b)(5) and are not subject to any restrictions against unlawful cross subsidization. In support of this remarkable (and unsupportable) position, Qwest asserts that the Commission’s rules on “chain transactions” only concerns transfers from the section 272 affiliate *to* the BOC, but not to transfers *from* the BOC to the section 272 affiliate.<sup>39</sup> In Qwest’s view, therefore, its new section 272 affiliate need never pay for (or disclose) its receipt of BOC assets and services so long as they are first “laundered” through an intermediate unregulated affiliate (here QCC). Qwest’s position is contrary to both the core purposes of section 272 and the Commission’s clear pronouncements in this area.<sup>40</sup>

Finally, Qwest fails to rebut AT&T’s showing that Qwest’s application does not comply with section 272’s accounting safeguards. In contrast to AT&T’s position, which is supported by one of the nation’s foremost experts on accounting, Qwest simply rounds up the usual suspects, Ms. Brunning and Ms. Schwartz. And the only analysis that they provide of these critical issues is to offer the unsupported assertion in a single sentence that QLDC and QC comply with the section 272 accounting safeguards.<sup>41</sup>

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<sup>38</sup> Qwest III Reply at 28-29 & n 42.

<sup>39</sup> Qwest III Reply at 28 (asserting that “affiliate transaction rules” do not apply “where the services or assets were originally provided (as opposed to ultimately *received*) by the BOC” (emphasis in original); *see also id.* at 28-29 (claiming that “it is neither a chaining transaction nor an improper cross-subsidy” where “the BOC provides an asset or service to QCC” that is later transferred to section 272 affiliate).

<sup>40</sup> *See, e.g. Accounting Safeguards Order* ¶¶ 183, 251; *Non-Accounting Safeguards Order* ¶ 309, *Michigan 271 Order* ¶ 373, *see also Non-Accounting Safeguards Order* ¶ 160 (holding that section 272(c)(1) dictates that “a section 272 affiliate and its interLATA competitors will have to follow the same procedures when obtaining services and facilities from a BOC”).

<sup>41</sup> *See* Qwest III, Brunning Reply Dec. ¶ 11 (“the policies and practices related to the accounting transactions currently under review by management and KPMG LLP for potential restatement

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This *ipsi dixit* cannot be taken seriously. Neither affiant purports to have undertaken any independent examination of Qwest’s accounting policies and practices and determined, in fact, that the current investigation does not impact any of the accounting policies and practices that are at issue here. Moreover, both affiants have in the past shown a willingness to profess GAAP-compliance where it does not in fact exist. In both the Qwest I and Qwest II proceedings, Ms. Brunsting affirmed that QCC “follows Generally Accepted Accounting Principles” and Ms. Schwartz affirmed that QC “follows Generally Accepted Accounting Principles.”<sup>42</sup> And while their testimony was amended after Qwest’s CFO conceded that both QCC and QC were not maintaining their books in accordance with GAAP, these affiants never retracted their prior, unequivocal assertions that QCC and QC were in compliance with GAAP.<sup>43</sup>

In all events, as Professor Holder explains in his accompanying declaration, Ms. Brunsting’s and Ms. Schwartz’s unsubstantiated claims cannot be credited. As an initial matter, as Professor Holder explains, mere assertions by management of GAM-compliance – unaccompanied by hard accounting evidence – are given no weight under the authoritative accounting literature.<sup>44</sup> Indeed, consistent with Commission precedent, “a proven track record of acceptable financial reporting in conformity with GAAP is required before companies are allowed to gain access to the capital markets.”<sup>45</sup> QLDC, of course, has no track record of **GAAP** compliance. And to the extent Qwest would point to the track record of its corporate family, that would call attention only to Qwest’s storied history of violating **GAAP**.

Moreover, Ms. Brunsting’s and Ms. Schwartz’s testimony cannot be squared with the securities filings Qwest has made with the SEC or basic accounting standards. As Professor Holder shows, those filings establish that: i) Qwest’s accounting policies themselves are under investigation, ii) Qwest has a history of pervasive and systemic non-compliance with GAM; and iii) Qwest’s internal investigation is ongoing and the full extent of Qwest’s problems is still not

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(. continued)

have not been and are not applied to QLDC”); Qwest III, Schwartz Reply Dec. ¶ 11 (“The accounting policies and practices that give rise to QC’s inability to certify its financial statements have been revised such that instances of material noncompliance with GAAP are not continuing and further do not affect GAAP compliance for transactions between QC and QLDC.”).

<sup>42</sup> See Qwest I, Brunsting Dec. ¶ 29, Qwest II, Brunsting Dec. ¶ 29; Qwest I, Schwartz Dec. ¶ 48; Qwest II, Schwartz Dec. ¶ 47.

<sup>43</sup> See August 27, 2002 *Ex Parte* Letter from Peter A. Rohrbach to Marlene Dortch (attaching revised Brunsting and Schwartz Declarations that continued to state unqualifiedly that QCC and QC “follow[] Generally Accepted Accounting Principles”).

<sup>44</sup> Holder *Ex Parte* Dec. ¶¶ 17-18

<sup>45</sup> *Id.* ¶ 19

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known. Given these facts, there can **is** no grounds for crediting mere assertions that QLDC and QC can and will comply with **GAAP**.<sup>46</sup> To the contrary, as Professor Holder concludes, “before there can be any reasonable assurance that QLDC and QC will be able to produce financial information that complies with GAAP in the immediate future, Qwest should finish its investigation, establish and test the functioning of adequate controls, and provide hard evidence of GAM-compliance that goes beyond mere representations.”<sup>47</sup>

Tellingly, neither Ms. Brunsting nor Ms. Schwartz make any claim that Qwest has, in fact, put into place the tested controls necessary to assure that GAAP-compliant policies – once they are put into place by Qwest – actually produce GAAP-compliant numbers. Instead, that argument is made by Qwest’s lawyers in Qwest’s reply comments. They state that, under the direction of Qwest’s new CFO, Qwest has begun the process of revising and strengthening its existing controls to ensure GAAP compliance going-forward.<sup>48</sup>

These unsworn factual claims, even if true, fall well short of demonstrating the existence of controls that can be relied upon by the Commission. As Qwest itself acknowledges, there can be no reasonable assurance that even appropriate accounting policies will produce GAAP-compliant records unless effective internal controls are in place. “The relevant question is whether a Section 272 affiliate has implemented internal control mechanisms reasonably designed to prevent, as well as detect and correct, any noncompliance with section 272.”<sup>49</sup> But the record is clear that such controls are not yet in place. As discussed above, Qwest has repeatedly acknowledged that its existing controls are inadequate, and, while it asserts that it is now in the process of developing new controls, it makes no claim that these controls have been adequately *tested*. Indeed, in August, Qwest acknowledged that it would take “months” to complete the review of “internal controls.”<sup>50</sup> This is critical, because the authoritative accounting literature makes clear that controls cannot be relied upon until they have been rigorously tested.<sup>51</sup> Thus, until Qwest can prove that it has both finished the task of reforming its inadequate controls, and that these new controls have been rigorously tested, there can be no reasoned finding that Qwest satisfied section 272.

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<sup>46</sup> *id.* ¶¶ 21-27

<sup>47</sup> *id.* ¶ 22.

<sup>48</sup> Qwest III Reply at 15-16.

<sup>49</sup> *Id.* at 14 (citations omitted)

<sup>50</sup> August 20 Shaffer Letter at 2.

<sup>51</sup> Holder *Ex Parte* Dec. ¶¶ 10-16, 28.

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Qwest's Enron-esque approach – attempting to divert attention from fundamental problems by shifting them off the books to a new affiliate – does not remotely solve its section 272 problems. Given Qwest's repeated past flouting of Section 271, the many instances of non-compliance with Section 272 and the numerous questions about its current accounting practices, anything but full and complete enforcement of the Act's clear accounting pre-conditions to section 271 authority would quite properly be viewed as reluctance by the Commission to do its part to combat accounting abuses. In the present environment, that would bring dishonor upon the Commission and send precisely the wrong message to the companies regulated by the Commission. Qwest's application should be denied.

Sincerely

A handwritten signature in black ink, appearing to read "C. Frederick Beckner", followed by a long, sweeping horizontal flourish.

C Frederick Beckner. 111

cc: Michelle Carey  
Michael Carowitz  
Bill Dever  
Michael Engel  
Janice Myles  
Gary Remondino

Enclosure

Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, DC 20554

In the Matter of	)
	)
Qwest Communications	)
International Inc.	)
	)
Consolidated Application for Authority	)
To Provide In-Region, InterLATA Services	)
in Colorado, Idaho, Iowa, Nebraska, North	)
Dakota, Montana, Utah, Washington, and	)
Wyoming	)

***EX PARTE* DECLARATION OF WILLIAM W. HOLDER**

**I. QUALIFICATIONS**

- 1     My name is William W. Holder. I have previously filed testimony in this proceeding in the form of a declaration
  
2.     I am the Ernst & Young Professor of Accounting at the University of Southern California ("USC"), which I joined in 1979. I teach undergraduate and graduate courses in the Leventhal School of Accounting and the Marshall School of Business at USC. Those courses focus on financial reporting in conformity with generally accepted accounting principles ("**GAM**") and auditing
  
- 3     I have written and published extensively on a wide range of financial reporting and auditing topics. My articles have appeared in the *Journal of Accountancy*,

*Accounting Review*, *Financial Executive*, *Research in Accounting Regulation* and many other academic and professional journals, research monographs and books. I have received the Robert Emmet Knox Education Achievement Award, by the California Society of Certified Public Accountants (“CPAs”) and the Distinguished Service Award, California Society of CPAs. I have lectured extensively to the American Institute of Certified Public Accountants, the American Accounting Association, the National Judicial College, the Federal Judicial Center and many others. In May 2002, I provided invited testimony before the Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises of the Committee on Financial Services of the United States Congress as they deliberated legislative action in response to widely publicized accounting and auditing failures, and I have recently delivered lectures on Corporate Governance and the implications of the recently enacted Sarbanes/Oxley Bill

- 4 I have served on a number of standard setting authorities of the accounting profession including the Accounting Standards Executive Committee and the Governmental Accounting Standards Board. Those groups set authoritative accounting and financial reporting standards for commercial and governmental entities within the United States. I am also a member of the board of directors of the American Institute of CPAs.
- 5 I have consulted extensively in a number of capacities including testifying in numerous state and federal trials. Certain of those engagements have centered on financial accounting, reporting and auditing matters related to wireless telephony.

issues similar to those in this matter. A more complete resume is provided as Exhibit 1 to this declaration.

11. **PURPOSE OF *EX PARTE* DECLARATION**

6 The purpose of my *ex parte* declaration is to respond to arguments made by Qwest in its reply comments and the supporting declaration of Ms. Brunsting and Ms. Schwartz. The first issue I address herein is Qwest’s assertion that “the chief financial officer of QCII, Oren Schaffer has implemented an extensive series of further controls reasonably designed to prevent, detect, and correct any noncompliance with GAAP.” The second issue I address relates to Ms. Brunsting’s and Ms. Schwartz’s assertions that the policies and practices currently under review by Qwest management and KPMG are not used by QLDC and that, notwithstanding the inability of QC’s management to certify its financial statements, those matters will not affect the transactions between QLDC and QCC.<sup>2</sup> In both instances, I conclude that, from the perspective of basic accounting, both claims are wrong.

7 I have based my declaration on relevant portions of the authoritative literature of the accounting profession, including that of the U.S. Securities and Exchange Commission (“SEC”), and the relevant knowledge and experience gained during my career. I have also reviewed the comments and declarations filed by Qwest in this proceeding pertaining to compliance with section 272, as well as the filings

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<sup>1</sup> Qwest III Reply at 15

<sup>2</sup> *Id.*, Brunsting Reply Dec ¶ 11, *id.*, Schwartz Reply Dec , ¶ 7

made by both AT&T and Qwest in connection with Qwest's previous in-region long distance applications. In addition, I have examined Qwest's filings with the SEC pertaining to Qwest's various investigation into its accounting policies and controls, as well as publicly available news accounts regarding those investigations into Qwest's accounting practices. Finally, I have read and considered the relevant statutory provisions and the Commission orders that have implemented those provisions.

**III. QWEST'S ASSERTIONS AS TO THE SUFFICIENCY OF ITS INTERNAL CONTROLS ARE FLAWED.**

8 In its reply comments, Qwest asserts that my prior declaration failed to recognize that Qwest has begun the process of revising its controls. This is a crucial issue. It is well recognized in the authoritative literature of the accounting profession that sufficient accounting controls need to be in place and operating effectively (*i.e.*, the policies must be applied and followed consistently) to be confident that the books, records and accounts are kept in the appropriate manner to support the preparation of the related financial statements in conformity with GAAP. According to Qwest, "the chief financial officer of QCII, Oren Schaffer has implemented an extensive series of further controls reasonably designed to prevent, detect, and correct any noncompliance with GAAP."<sup>3</sup> Even if true, this representation is insufficient to demonstrate effective controls.

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<sup>3</sup> Qwest 111 Reply at 1

- 9     **As** 1 explained in my prior declaration, a company’s internal control is defined in the following manner. Internal control is

**A** process – effected by an entity’s board of directors, management and other personnel – designed to provide reasonable assurance regarding the achievement of objectives in the following categories (a) reliability of financial reporting . . . and (c) compliance with applicable laws and regulations Internal control consists of five interrelated components, which are:

*Control environment* sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.

*Risk Assessment* is the entity’s identification and analysis of relevant risks to achievements of its objectives, forming a basis for determining how the risks should be managed.

*Control Activities* are the policies and procedures that help ensure that management directives are carried out.

*Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

*Monitoring* is a process that assesses the quality of internal performance over time.<sup>4</sup>

10.     **As** previously noted, the process of designing, developing, installing, operating, testing and evaluating internal accounting controls for a company such as Qwest is extensive and time consuming. The volume and complexity of transactions, and the extent of information to be captured and processed in a reliable manner that facilitates the preparation of financial statements in conformity with GAAP,

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<sup>4</sup> ATCPA, AU § 3 19.06

require planning, construction, implementation, testing and evaluation. Further, it is generally recognized that senior management sets the “tone at the top” and that it requires time to affect and change a “corporate culture.” Each of these factors suggests that the controls necessary for a company such as Qwest are complex and require testing and evaluation with live data and transactions before one can be confident that they will function as designed

- 11 The authoritative literature of the accounting profession supports this position. For example, before reliance can be placed on controls to record, process, summarize, and report financial information in conformity with GAAP, controls must be found to have been operating effectively throughout the period to which the financial statements pertain.<sup>5</sup> In other words, assessment of controls requires “[p]erforming *tests* of controls to evaluate the effectiveness of such controls.”<sup>6</sup> Specifically, AU Section 319.70 states that before controls can be relied upon in any meaningful way, there must **be** an identification of the “specific controls relevant to specific (financial statement) assertions” and a “test of [those] controls.”<sup>7</sup>

12. The authoritative literature of the accounting profession also specifically recognizes that *tests* of controls should be developed and applied to test the design

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<sup>5</sup> AICPA, AU §§ 319.58- .78, 325.042

<sup>6</sup> AICPA, *Audit Guide*, “Consideration of Internal Control in a Financial Statement Audit,” ¶ 3.06 (emphasis added).

<sup>7</sup> AICPA AU § 319.70

of the system and the manner in which it has operated *before reliance on it is appropriate*. Specifically, it states:

Procedures directed toward evaluating the effectiveness of the *design* of a control are concerned with whether that control is suitability designed to prevent or detect materials misstatements in specific financial statement assertions. Procedures to obtain such evidential matter ordinarily include inquiries of appropriate entity personnel; inspection of documents, reports or electronic files; and observation of the application of specific controls. . . . Tests of controls directed toward the operating effectiveness of a control are concerned with how the control was applied, the consistency with which it was applied during the audit period, and by whom it was applied.’

13. It, therefore, is clear that before relying on the quality of internal controls the design of the control system as well as specific control features must be tested after it has been placed in operation. The reason for this is straight-forward. Because of the complexity of such systems, the possibility of unrecognized design flaws, and their susceptibility to subtle unintended and unobserved deficiencies in the functioning of specific control features, controls can only be relied upon if they have been rigorously tested
14. In this regard, the authoritative literature establishes engagements that would have allowed Qwest to retain CPAs to provide independent assurance about the quality and reliability of its internal accounting controls. **As** explained, however, such an engagement would require the attesting CPA to apply procedures to test the functioning of controls, and the CPA cannot simply rely on management representations or an evaluation of the design of the system. The objective of

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<sup>8</sup> AICPA, AU §§ 319.75-319.76(emphasis added)

such an engagement “is to express an opinion on (a) the effectiveness of the entity’s internal control, in all material respects, based on the control criteria or (b) whether the responsible party’s written assertion (management of QLDC, in this matter) about the effectiveness of internal control is fairly stated.” If obtained by Qwest, such an opinion from an independent CPA would add considerable reliability to Qwest’s representations about the quality of their internal accounting control system, however, in order to obtain such assurances the company has to have placed the new system in operation for a period of time so that an auditor could test its functioning and not merely evaluate its design characteristics.

15. Qwest, however, offers no such independent evaluation and assurance. To the contrary, all acknowledge that Qwest’s existing controls that have an operating track record are inadequate and that the design and functioning of the new control system alluded to by Qwest are untested. Indeed, Qwest’s CFO, Mr. Oren Shaffer, has acknowledged both that “the company needs to enhance certain internal controls”<sup>9</sup> and that these “new internal controls that are needed will be identified and implemented” subject to a “thorough analysis of accounting practices for past periods” which “is expected to take several months before it is

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<sup>9</sup> AU § 501.16.

<sup>10</sup> Qwest August 16, 2002 8-K at 12.

completed.”“ Thus, even once the new controls have been put into place, the functioning and reliability of those new controls must be tested before they can be determined to be reliable. In short, the new control system must be put into operation, tested and evaluated. Until this is accomplished, there can be little assurance that QLDC will be able to record its transactions in a manner that complies with GAAP.

- 16.** In conclusion, there is no dispute that Qwest’s existing controls are inadequate – indeed Qwest’s CFO has conceded this to be the case<sup>12</sup>. And before Qwest can reasonably assert that its new internal accounting controls are sufficient to provide reasonable assurance that the results of processing substantial amounts of information will result in financial information that complies with GAAP, those controls must have been determined to operate effectively. Based on the analysis presented above, the bare representations made in Qwest’s reply comments clearly do not provide any significant evidence of the effectiveness of QLDC’s internal accounting controls because, even assuming the representations are correct, it must be demonstrated that Qwest’s controls have to be put into operation and subjected to appropriate testing. Qwest has provided no such evidence

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<sup>11</sup> *Ex Parte* Letter from Oren Shaffer to Marlene Dortch, WC Dockets No 02-148, 02-189, at 2 (August 26, 2002). *See also Ex Parte* Letter from Oren Shaffer to Marlene Dortch, WC Dockets No 02-148, 02-189, at 2 (August 20,2002)

<sup>12</sup> *See Ex Parte* Letter from Oren Shaffer to Marlene Dortch, WC Docket Nos 02-148, 02-189(August 20,2002).

**IV. QWEST'S UNSUPPORTED ASSERTIONS THAT QLDC AND QC ARE UNAFFECTED BY QWEST'S PERVASIVE AND SYSTEMIC ACCOUNTING PROBLEMS CANNOT BE CREDITED.**

17 In their reply declarations, Ms. Brunsting and Ms. Schwartz assert – without any analysis or citation – that the policies and practices related to the accounting transactions currently under review by Qwest management and KFMC are not used by QLDC and that, notwithstanding the inability of QC's management to certify its financial statements, those matters will not affect the transactions between QLDC and QC.<sup>13</sup> For the reasons, that I discussed in my previous declaration I do not believe that such representations provide sufficient evidence that the books of QLDC can reliably be expected to be prepared in conformity with **GAAP**. Likewise, this same analysis shows that there is no basis for concluding that QC is recording its transactions with QLDC in conformity with **GAAP**.

18. **As** an initial matter, Ms. Brunsting's and Ms. Schwartz's representations do not, from a basic accounting perspective, provide sufficient evidence that QLDC will be able to comply with the accounting provisions of section 272. **As I** explained in my prior declaration, mere management representations are an insufficient basis to support a CPA's professional opinion that financial statements are presented in conformity with **GAAP**. That literature recognizes that management representations do not provide sufficient competent evidence to support a professional opinion that financial statements are presented fairly in conformity

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<sup>13</sup> Qwest III Reply, Brunsting Reply Dec. ¶ 11; *id.*, Schwartz Reply Dec., ¶ 7.

with GAAP. Specifically, it states’ “[s]uch representations from management are part of the evidential matter the independent auditor obtains, but they are *not* a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements . . . .”<sup>14</sup>

- 19 In this regard, the fact that QLDC is “new,” rather than being a reason for finding GAAP-compliance, is a reason for finding that there is no reasonable assurance that QLDC will maintain its books, records, and accounts in conformity with GAAP. I understand that the Commission has held that “past and present behavior of the BOC applicant [is] the best indicator” as to whether the BOC will comply with section 272.<sup>15</sup> As discussed in my original declaration in this matter, the FCC’s holding is consistent with basic positions taken by a number of other accounting regulators. For example, the SEC generally requires a company to provide audited financial statements presented in conformity with GAAP before allowing the company to register its securities and access the U. S. capital markets (*i.e.*, go public). Other regulators that also require audited financial statements do not rely on financial statements supported only by the representations of management that the financial statements are presented fairly in conformity with GAAP.<sup>16</sup> And, as noted, the authoritative accounting literature recognizes that

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<sup>14</sup> American Institute of Certified Public Accountants (“AICPA”), Professional Standards, Vol. I, AU § 333.02 (emphasis added)

<sup>15</sup> *Michigan 27f Order*, 12 FCC Rcd. 20543, ¶ 347 (1997).

<sup>16</sup> For example, the U. S. Department of Labor and the Internal Revenue Service generally require audits of the financial statements of pension plans subject to the Employee Retirement Income Security Act of 1974 (“ERISA”). Similarly, the Single  
(continued. . .)

management representations do not provide sufficient competent evidence to support a professional opinion that financial statements are presented fairly in conformity with **GAAP**.

20 These positions of the SEC, other federal regulatory agencies, and professional standard setters make clear that a proven track record of acceptable financial reporting in conformity with GAAP is required before companies are allowed to gain access to the capital markets of the U.S and that management representations are generally not considered sufficient to support reliance on financial statements. As previously stated, it is difficult to conceive of a reason why the Federal Communications Commission would be satisfied with *no* track record of accounting compliance in enforcing a safeguard intended to protect the public interest and competition. And to the extent that QLDC is judged on the basis of the history of its affiliates and parent, as Qwest suggests, that history is one of non-compliance.

21. Moreover, there are particularly strong reasons for not accepting Qwest's representations regarding QC's and QLDC's accounting policies and procedures. The sum total of the evidence provided by Qwest may be summarized as follows:

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( . continued)

Audit Act of 1984 requires financial statement audits that are even more extensive than those performed in accordance with GAAS for recipients of significant Federal financial assistance.

The policies and practices related to the accounting transactions currently under review by management and KPMG LLP for potential restatement have not been and are not applied to QLDC <sup>17</sup>

The accounting policies and practices that give rise to QC's inability to certify its financial statements have been revised such that instances of material noncompliance with **GAAP** are not continuing and further do not affect GAAP compliance for transactions between QC and QLDC <sup>18</sup>

22 In my professional view, these assertions cannot be relied on in any significant manner. Rather, given the fact that i) Qwest's accounting policies themselves are under investigation, ii) Qwest has a history of pervasive and systemic non-compliance with **GAAP**, and iii) Qwest's internal investigation is ongoing and the full extent of Qwest's problems is still not known, there is simply no basis for to accept mere management representations that Qwest or its affiliates can and will comply with GAAP. Rather, in my professional view, before there can be any reasonable assurance that QLDC and QC will be able to produce financial information that complies with GAAP in the immediate future, Qwest should finish its investigation, establish and test the functioning of adequate controls, and provide sufficient evidence of GAM-compliance that goes beyond mere representations.

23. Significantly, it is Qwest's accounting policies themselves, and not just the application of those policies, that are under investigation." And it likewise clear

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<sup>17</sup> Qwest III Reply, Brunsting Reply Dec. ¶ 11

<sup>18</sup> Qwest III Reply, Schwartz Reply Dec. ¶ 11

<sup>19</sup> See, e.g., August 16, 2002 Qwest 8-K at 5,6, 9-10 ("KPMG has been analyzing the company's financial information and has provided input regarding its preliminary views (continued )

that there are problems with Qwest's policies throughout the Qwest family of companies. Qwest has acknowledged that QC's financial statements and books (as well as those of its parent, QCII) cannot be relied on to comply with **GAAP**.<sup>20</sup> Indeed, it is for precisely these reasons, among others, that Qwest's current auditor, KPMG, cannot provide an opinion on Qwest's financial statements at this time.

24. As noted in my original declaration, it is also clear that Qwest's accounting and financial reporting problems extend well-beyond its policies regarding the sales of IRUs. Indeed, Qwest has announced new policies to deal with the restatement of optical capacity asset swaps and appears to have put in place new accounting policies for optical capacity sales.<sup>21</sup> Yet, despite having come to grips with these problems, Qwest is still unable to represent that it has identified and resolved each of its accounting and financial reporting problems. To the contrary, in announcing that it would restate its earnings to reflect the proper treatment of optical capacity swaps, Qwest frankly acknowledged that "in addition" it is "continuing to analyze certain accounting policies and procedures with respect to other transactions," that the investigation is "ongoing," and that it could not "state

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( continued)  
on certain Qwest accounting policies, practices and procedures. Those views have been, and are continuing to be, considered as part of the company's internal analysis. KPMG has not completed its analysis.")

<sup>20</sup> See *Ex Parte* Letter from Oren Shaffer to Marlene Dortch, WC Docket Nos. 02-148, 02-189 (August 20, 2002).

<sup>21</sup> Qwest September 22, 2002 8-K at 5-6.

with certainty when a restatement would be completed”<sup>22</sup> According to its October 30, 2002 Form 8-K, and as discussed more completely in the following paragraphs, those conditions continue to exist<sup>23</sup>

25 Qwest’s accounting and financial reporting problems are widespread and systemic as revealed by other published reports That is, they extend to a range of financial accounting and reporting issues and involve a number of individuals For example, evidence indicating that Qwest sales employees had entered into secret side deals in connection with Qwest’s IRU sales was presented in recent Congressional hearings<sup>24</sup> Similarly, reports suggest that certain transactions with outside entities were designed to achieve short-term earnings management goals rather than for sound business operating activities<sup>25</sup> In short, as noted in my prior declaration, Qwest’s problems are not simply the result of the failure of a few former employees to follow proper procedures in a handful of areas, but the result of numerous flawed accounting policies and numerous employees at many levels of the company deviating from basic accounting controls and accepted practices

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<sup>22</sup> *Id.* at 1.

<sup>23</sup> Qwest October 30, 2002 8-K at 2

<sup>24</sup> For examples, see The Wall Street Journal, September 19, 2002, p. B8; The Orange County Register, September 19, 2002, p. Business 10; the Los Angeles Times, September 25, 2002, p. C11; The Wall Street Journal, September 24, 2002, p. B3

<sup>25</sup> For examples, see: The Los Angeles Times, September 19, 2002, p. C1 The Los Angeles Times, September 20, 2002, p. C1 and C10.

- 26 The most recent information available from Qwest indicates that the problems endure to the time of this writing. In an October 30, 2002 filing with the SEC, Qwest acknowledges that it cannot file its Form 10-Q for the most recent fiscal quarter's operating results. Specifically, Qwest states: "Until the restatement is completed and KPMG has completed the re-audit of the relevant periods, the company anticipates that it will not be in a position to file its Quarterly Report on **Form 10-Q**."<sup>26</sup> Qwest goes on to indicate that it expects to file an additional Form 8-K containing additional accounting information; however, it also recognizes: "this additional information will not be a substitute for the disclosure required in the Form 10-Q . . . ."<sup>27</sup> Given the continuing accounting and financial reporting difficulties being experienced by Qwest including its inability to prepare and submit quarterly reports (Form 10-Q) to the SEC, it is difficult to accept that the internal controls and accounting system of QLDC and its transactions with other Qwest affiliates will comply with relevant FCC requirements.
- 27 I also conclude that Ms. Brunsting's and Ms. Schwartz's assertions that Qwest's accounting problems do not impact QLDC or the QLDC-QC transactions are not reliable because they are inconsistent with the sworn statements made by Mr. Shaffer and Mr. Notebaert. In their August 16, 2002 submissions to the SEC, these Qwest officers stressed that the full extent of Qwest's problems was not known. According to Messrs. Notebaert and Shaffer, the investigation into

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<sup>26</sup> Qwest October 30, 2002 **8-K** at 2

<sup>27</sup> *Id.*

Qwest's accounting practices is at a "preliminary" stage and far from "complete."<sup>28</sup> They also acknowledge that "new issues may be raised by the company's internal analyses, or by KPMG" and that, at this writing, KPMG is still performing a reaudit of previously issued financial statements<sup>29</sup> And, as Qwest's states in several other securities filings, Messrs. Notebaert and Shaffer are unable to state when the existing review will be concluded.<sup>30</sup> Given that Qwest's senior officials are on record stating that the full extent of Qwest's problems are not known, in my view there is an insufficient basis for Ms. Brunsting and Ms. Schwartz to claim to this Commission that QLDC's books and QLDC-QC transactions have not been and will not be affected by Qwest's accounting problems.

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<sup>28</sup> August 16, 2002 Qwest 8-K at 5,6, 9-10 ("KPMG has been analyzing the company's financial information and has provided input regarding its preliminary views on certain Qwest accounting policies, practices and procedures. Those views have been, and are continuing to be, considered as part of the company's internal analysis. KPMG has not completed its analysis.").

<sup>29</sup> *Id.* at 6, 11; see also *id.* at 5-6, 10-11 ("The internal analyses are not complete. I believe that the internal analyses, now being directed by new management and being informed by the views of new auditors, will result in a conclusion that the restatement of financial information and that the amendment of prior filed reports, including covered reports, will be necessary. Subsequent to the date of this statement under oath, new issues may be raised by the company's internal analyses, or by KPMG."). See also *id.* at 6, 11 August 8, 2002 Qwest 8-K at 1 ("The company is consulting with its new external auditors, KPMG LLP, on the scope of a restatement and what adjustments would be required. Until such time as these efforts have been concluded, the company cannot indicate the extent to which the results for 2000-2002 will be impacted"); Qwest October 30, 2002 8-K at 2 ("Until the restatement is completed and KPMG has completed the re-audit of the relevant periods, the company anticipates that it will not be in a position to file its Quarterly Report on Form IO-Q.").

<sup>30</sup> August 16, 2002 Qwest 8-K at 6, 10; see also August 19, 2002 Qwest 8-K at 2.

28. The completion of Qwest's internal investigations, however, is only one of several necessary steps that Qwest must take before it can provide reasonable assurance to the Commission that it can satisfy the Commission's **GAAP** accounting requirements. Accounting policies are not self-executing. They only function as well as do the people implementing them. Even perfect accounting policies will not result in appropriately maintained books and records unless those policies are followed by Qwest's sales, accounting and other personnel. Thus, as explained above, there can be no reasoned finding that QLDC's books, or QC's books to the extent they reflect transactions with QLDC, are – and will be – consistent with **GAAP** until Qwest puts into place revised controls that have been demonstrated to be effective.
29. In sum, there is, in my opinion, currently insufficient evidence to find that, as required by section 272(c)(2), transactions between QC and QLDC comply with **GAAP** or, as required by section 272(b)(2), that QLDC will maintain its “books, records, and accounts” in accordance with **GAAP** until Qwest has completed its internal investigations, revised its deficient policies, and put into place and tested new, compliance controls. This is not just my view, but that of Qwest's own accountants.

**KPMG** has informed us that due to the identification of the adjustments that we believe we are required to make in our financial statements, the ongoing analyses by us and **KPMG** of our accounting policies and practices, analyses of our internal controls and the inability of our chief executive officer and chief financial officer to [certify Qwest's financial statements], **KPMG** is not able to complete, as of the date of this Current Report on Form 8-K, all the procedures necessary to finalize its review of the financial statements to be included in the second quarter of

2002 report on Form 10-Q required by the regulations under the federal securities laws<sup>31</sup>

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<sup>31</sup> August 19, 2002 *Qwest* 8-K at 4

**VERIFICATION**

I, William W. Holder, declare under penalty of perjury that the foregoing is true and correct. Executed on <sup>Nov. 7</sup>~~October~~, 2002.

William W. Holder